MERCER
Human Resource Consulting

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Compensation Committee Meeting

Proposed Equity Strategy

Diane L. Doubleday
San Francisco

MMC Marsh & McLennan Companies

G:comp/clients/premera/execcomp/2003/conversionmaterials/Board10.17.03v8.ppt

Plan Provisions

- "Omnibus" Plan is a stock plan that provides the company flexibility to grant different types of equity vehicles. This is a normal practice for publicly-traded companies. The draft plan for Premera includes authority to grant:
  - Stock Options
  - Restricted Stock (stock with vesting contingent on performance or service)
  - Performance Shares/Units (award for achieving performance goals)
  - Stock Appreciation Rights (right to appreciation on specified number of shares; can be settled in shares or cash; can be granted stand-alone or in tandem with options)

Recommended Approach for Years 1 & 2

- 7% share reserve
  - One-time IPO grant to all non-officer employees
  - Annual option grants to management*
  - Annual option grants to board of directors*
  - LTIP grant for 2005-2007 cycle**
    - Replacement of stock for cash in current LTIP
    - Current in-progress LTIP cycles continue with cash payout

October 17, 2003, Board modification: Waiting Period—No grants can be made until 3 months after Conversion

*~~Waiting period to be discussed~~

**Assumes conversion occurs in 2004 and the 2005-2007 cycle is the first new LTIP cycle after conversion

Other Terms

- Eliminate mandatory deferral of annual incentive plan and LTIP payouts and associated matching contribution prospectively as of the effective date of conversion*
- No plans to change AIP and LTIP with respect to opportunity levels and general structure
  - goals and weighting may change as determined by the board from time to time

* Match would continue to apply to amounts already subject to mandatory deferral

Total Shares Reserved

Total shares reserved for first two-year period is 7.0% of common shares outstanding (CSO)

- Year One
  - One-time broad-based option grant: 1.55%
  - Management annual option grant: 1.48%
  - Annual board of director option grant: 0.18%
- Year Two
  - Management annual option grant: 1.48%
  - LTIP grant: 0.67% (maximum award for outstanding performance)
  - Annual board of director option grant: 0.18%
- Reserve Pool: 1.46% to be used for grants such as:
  - New hires or promotions
  - Recognition awards to high performers
  - Extending LTIP eligibility lower in organization
  - CEO & EVPs (other than those hired or promoted) are not eligible for grants from the reserve for the first two years

Market Practices:

- Recently converted Blues have reserved 5-10% (median 6.1%) of CSO under the stock plan.
- These reserves typically cover a period of 2-3 years.
- Large, public companies' total shares reserved in 2002 ranged from 11% to 20% of CSO.

One-time Broad Based Grant

- 1.55% of CSO reserved for a one-time broad based option grant to
  - Exempt employees
  - Non-exempt employees
  - Excluded: executives (VPs and above) and non-employee members of the board

Market Practices:

- Most Blues granted 2-4% of CSO in the initial year following IPO.
- About half of total grants went to the top 5 executives (median grant was 1.4% of CSO).

Ongoing Annual Option Grant

- 1.66% of CSO reserved for annual option grant to
  - Director-level employees and above (1.48% of CSO)
  - Non-employee members of the board (0.18% of CSO)

Market Practices:

- Among large, public companies, 2002 annual grant rates ranged from 1.1% to 2.6% of CSO for all employees.
- For a subset of public healthcare companies, 2002 grant rates ranged from 1.3% to 2.2% of CSO, with a median of 1.7%.
- Anthem granted 1.1% of CSO in 2002 and in 2001.
- Among Blues, the median waiting period between IPO and initial grants to executives was 6 months.

Long Term Incentive Plan (LTIP)

- Share reserve includes LTIP grant for the 2005 - 2007 performance cycle
  - Plan will pay in performance shares
  - This is a replacement for the existing cash payout (i.e., not an additional award)
- Participants in LTIP
  - [ ] and above PROPRIETARY MATERIAL REDACTED
- Shares are awarded at the beginning of the performance period based on the achievement of pre-determined goals
  - Grant is [ ] of CSO for the cycle assuming maximum-level performance PROPRIETARY MATERIAL REDACTED
  - Actual award will depend on performance

*Assumes conversion occurs in 2004 and the 2005-2007 cycle will be the first new LTIP cycle after conversion

Equity Strategy
Total Shares Reserved

- Total shares reserved is 7% of CSO; covers a period of two years.
- A pool of shares (1.46% of CSO) is reserved for out of cycle awards (e.g., new hires, promotions, additional grants to high performers).

	One Time IPO Grant	Exec Annual Grant	BOD	Exec Annual Grant	LTIP[1] Threshold	LTIP[1] Target	LTIP[1] Maximum	BOD	Total Shares Granted
CEO									
EVP's									
SVP									
VPED's									
VP's									
Directors									
Managers									
Exempt Employees									
Non-Exempt Employees									
Outside BOD's									
Reserve Pool[2]									
Shares									
% of CSO	1.55%	1.48%	0.28%	1.48%			0.67%	0.18%	7.00%
Total Shares % of CSO									7.00%

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Assumptions:

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[1] Replacement of existing cash LTIP plan.

[2] Pool reserve is available throughout the 2-year period.

Equity Strategy – Oct. 2003 Recommendation

Individual Awards

- With target LTI awards and option grants, total direct compensation approximates the median of the healthcare market for the top executive officers and for board members (see pg. 14)

Employee Level	One Time IPO Grant (Options)	Exec Annual Grant (Maximum Options)	Annual BOD Grant (Options)	3 Year LTIP (Maximum Performance Shares)
CEO				
EVP, Chief Legal (Milo)	PROPRIETARY MATERIAL REDACTED			
EVP, Health Care Svcs. (Ancell)			PROPRIETARY MATERIAL REDACTED	
EVP, Chief Marketing Exec. (Donigan)				
EVP, CFO (Marquardt)				
SVP's				
VPED's				
VP's				
Director-level employees				
Managers	PROPRIETARY MATERIAL REDACTED			
Exempt Employees			PROPRIETARY MATERIAL REDACTED	
Non-Exempt Employees				
Outside Board members				

Equity Strategy
Recommended Stock Option Terms: Employees

Term	Definition
Vesting	4 years, 25% per year
Option Term	10 year maximum
Exercise Price	Fair market value on the date of grant
Consideration for Exercise	Cash or previously owned shares valued at current market; cashless exercise
Voluntary/Involuntary Termination	Employee will have 3 months (or the remaining term) following the termination date to exercise vested options. Unvested options are forfeited
Death/Disability	Employee (or estate) will have 1 year (or remaining term if shorter) to exercise all vested awards; unvested options accelerate
Retirement	Employee will have 1 year (or remaining term if shorter) to exercise all vested awards*
Change-in-Control	Within 2 years of conversion, options are not accelerated on CIC even if optionee is terminated. Thereafter, options are accelerated if they are not assumed or substituted by acquirer or if optionee is terminated before close on account of CIC. Assumed or substituted options accelerate if optionee is terminated during CIC window.
Repricing	Not permitted
Stock Option Transferability	Allowed to immediate family members or trustees for the benefit of optionee and family members

October 17, 2003 Board modification:

~~*Treatment of unvested options to be discussed~~

Unvested options accelerate at Retirement [(i) age 55 and 10 years of Continuous Service, or (ii) after age 55 so long as the sum of age and years of Continuous Service is at least 65]

Equity Strategy
Recommended Stock Option Terms: Board of Directors

Term	Definition
Vesting	3 year pro rata (one third on each anniversary of grant)
Option Term	10 year maximum
Exercise Price	Fair market value on the date of grant
Consideration for Exercise	Cash or previously-owned shares valued at current market
Termination Due to Term Limit	Accelerated vesting of unvested grants and 1 year to exercise
Death/ Disability	1 year (or remaining term if shorter) to exercise all vested awards; unvested options accelerate
Voluntary/Involuntary Termination	If director does not stand for election, is not elected or terminates service other than because of death, disability or term limits, any unvested grants lapse and director has 3 months (or remaining option term if shorter) to exercise vested options
Change-in-Control	No acceleration
Repricing	Not permitted
Stock Option Transferability	Allowed to immediate family members and trustees for the benefit of optionee and family members

Equity Strategy

Total Direct Compensation (Peer Group & Survey Blend)

Incumbent	Title	2002 Base Salary	Target TCC	Target LTIP Value[1]	Option Value[2]	TDC	50th %ile	75th %ile	50th %ile	75th %ile
		Premera Compensation					Blended Market TDC*		Premera Variance to Market	
Brereton Barlow	President & CEO	$650								
Yori Milo	EVP, Chief Legal & Public Policy	$407								
Brian Ancell	EVP, Health Care Svcs. & Strategic Dev	$308	PROPRIETARY MATERIAL REDACTED				PROPRIETARY MATERIAL REDACTED			
Heyward Donigan	EVP, Chief Marketing Executive	$308								
Kent Marquardt	EVP, Chief Financial Officer	$300								
Average										

[1] *LTIP value is calculated assuming a target award, a[ ]and 2002 base salary aged from 2002 to 2005 by[ ]annually*

[2] *Option value assumes a[ ]*

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* *2002 market data aged to February 1, 2003*

Note: Data in thousands

Equity Strategy
Total Direct Compensation (Board of Directors)

Company Name	Revenue (in millions)	Total Cash Compensation	Annual Equity Compensation	Total Equity Compensation	Total Direct Compensation
Pacificare, Inc.	$11,844	$90,000	$55,518	$111,036	$201,036
Humana Inc.	$10,195	$44,500	$50,016	$105,026	$149,526
Health Net, Inc.	$10,064	$72,000	$105,275	$126,330	$198,330
WellChoice Inc.	$4,631	$74,500	$0	$0	$74,500
Oxford Health Plans, Inc.	$4,421	$55,000	$92,431	$92,431	$147,431
Coventry Health Care Inc.	$3,147	$41,750	$43,345	$43,345	$85,095
Mid Atlantic Med. Svcs, Inc.	$1,793	$38,500	$60,574	$84,803	$123,303
Cobalt Corp.	$1,439	$46,504	$13,621	$29,967	$76,471
Sierra Health Services, Inc	$1,292	$32,000	$23,681	$28,417	$60,417
American Medical Security Grp.	$877	$40,600	$55,178	$62,075	$102,675
75th Percentile	$8,706	$67,750	$59,310	$101,877	$149,002
Median	**$3,784**	**$45,502**	**$52,597**	**$73,439**	**$112,989**
Average	$4,970	$53,535	$49,964	$68,343	$121,878
25th Percentile	$1,527	$40,888	$28,597	$33,311	$78,627
Premera: Pre-Conversion	**$2,600**	**$44,500**	**$0**	**$0**	**$44,500**
Premera: Post-Conversion Recommendation[1]		PROPRIETARY MATERIAL REDACTED			
				Premera vs. Peer Group Median	***106%***

Source: 2002 proxy statements.

[1] Premera's recommended total cash compensation includes a [ ] annual retainer, [ ] in annual committee fees, [ ] in Board fees, and [ ] in an annual committee retainer. Annual equity compensation assumes each director receives an annual grant of [ ] options at [ ] with a [ ] Black-Scholes value.

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